

MINUTES OF THE SENATE COMMITTEE ON TRANSPORTATION AND TOURISM

The meeting was called to order by Chairman Ben Vidricksen at 9:10 a.m. on March 5, 1998 in Room 254-E of the Capitol.

All members were present except:

Committee staff present: Hank Avila, Legislative Research Department
Bruce Kinzie, Revisor of Statutes
Marian Holeman, Committee Secretary

Conferees appearing before the committee: Ed Huddleston, Driscoll & Draude

Others attending: See attached list

HB 2687: Terminal rent adjustment clauses TRAC vehicle leasing in Kansas.

Last year this was SB 118. It was passed out of this committee on March 5, 1997. It went to the Senate floor and was passed out on March 12, 1997. In the House a financial institutions bill was amended into it and the bill was lost completely. Members received copies of testimony in support of HB 2687 presented to the House Transportation Committee by Tom Whitaker, Kansas Motor Carriers Association, on February 5, 1998. (Please see House Committee Minutes of 2-5-98 for that report).

Edwin E. Huddleston, III with Driscoll & Draude, Washington, D. C. presented testimony on behalf of Kansas companies supporting HB 2687 (Attachment 1). He has worked closely with our Revisor. Thirty-eight other states have already enacted this legislation. As of this date, they simply have not gotten around to all states. Mr. Huddleston requested an amendment to Section l(b) to further explain that this section clarifies existing law and shall be given effect in all court cases brought on or after the effective date of the act and that it takes effect after publication in the Kansas Register. This is an attempt to clarify technical arguments. Senator Jordan moved to so amend HB 2687. Senator Salmans seconded the motion. Motion carried. Senator Vidricksen moved to pass the bill out favorably as amended. Senator Jordan seconded the motion. Motion carried. Senator Karr will carry the bill.

The meeting adjourned at 9:45 a.m.

The next meeting will be March 9, 1998.

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March 3, 1998

Senator Ben Vidricksen
Chairman
Senate Transportation Committee
State Capitol- Room 143
Topeka, Kansas 66612
VIA FEDERAL EXPRESS

Tel: (785) 296-7390

Re: TRAC vehicle leasing in Kansas:
House Bill 2687

Dear Senator Vidricksen:

Twenty-five (25) copies of written testimony are enclosed for the Senate Transportation Committee hearings on House Bill 2687 scheduled for this Thursday, March 5, 1998, 9:05 a.m., Room 254 East. Please let me know whether you would like me to testify in person to supplement this written statement. I will continue to call you about this.

One technical, clarifying amendment should be made to Section 1(b) of the bill, to make sure that the legislation brings the immediate relief that is intended:

(b) This section shall be part of and supplemental to the uniform commercial code. This act clarifies existing law and shall be given effect in all court cases brought on or after the effective date of the act. [New language in italics]

House Transportation Committee Chairman Gary Hayzlett told me he supported this technical clarification, and that there would be no problem with it in Conference.

Thank you again for your support of this bill!

Yours very truly,

Edwin E. Huddleson, III

Enclosures

Senate Transp. & Tourism
3-5-98
Attachment #1

STATEMENT IN SUPPORT OF HOUSE BILL 2687
(TRAC VEHICLE LEASING)

Presented on Behalf of Kansas Companies
Supporting House Bill 2687

NationsBank
First National Bank of Hutchinson, Kansas
Transamerica Business
Baystone Financial Group

and on behalf of

American Automotive Leasing Association
Equipment Leasing Association

Edwin E. Huddleson, III
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March 5, 1998

HOUSE BILL No. 2687

By Committee on Transportation

1-22

9 AN ACT concerning vehicles; relating to terminal rent adjustment
10 clauses.

11

12 *Be it enacted by the Legislature of the State of Kansas:*

13 Section 1. (a) Notwithstanding any other provision of law, an agree-
14 ment involving the leasing of a motor vehicle or trailer does not create a
15 sale or security interest solely because the agreement provides for an
16 increase or decrease adjustment in the rental price of the motor vehicle
17 or trailer based upon the amount realized upon sale or other disposition
18 of the motor vehicle or trailer following the termination of the lease.

19 (b) This section shall be part of and supplemental to the uniform
20 commercial code-leases.

21 Sec. 2. This act shall take effect and be in force from and after its
22 publication in the statute book.

TRAC VEHICLE LEASING IN KANSAS

o **TRAC vehicle leasing.** TRAC vehicle leasing is a well-established, decades-old business that involves the leasing of commercial fleets of motor vehicles (cars and trucks) by one business to another. While specific transactions vary, in general a Terminal Rental Adjustment Clause (TRAC) permits (or requires) an upward or downward adjustment of rent to make up for any difference between the projected value of a vehicle and the actual value upon lease termination. The objective of TRAC vehicle leases is to provide a financial incentive for the lessee/user, who is the party to the transaction best able to control the maintenance of the vehicle, to keep the vehicle in good repair.

TRAC vehicle leasing is limited by federal tax law (see 26 U.S.C. 7701(h)) to a commercial business context; TRAC vehicle leasing does not involve leasing to consumers.

TRAC motor vehicle leasing became increasingly popular after the end of World War II so that, today, most fleets of leased vehicles in America are covered by the TRAC form of lease. The Equipment Leasing Association (ELA) and the American Automotive Leasing Association (AALA) estimate that there are over 5 million leased vehicles now on the roads operating under TRAC leases. Over 124,000 fleet vehicles are in operation in Kansas, most of which are leased and/or managed by AALA members.

o **TRAC legislation.** Our proposal would add the following new provision to Kansas law:

TERMINAL RENTAL ADJUSTMENT CLAUSES: VEHICLE LEASES THAT ARE NOT SALES OR SECURITY INTERESTS

In the case of motor vehicles or trailers, notwithstanding any other provision of law, a transaction does not create a sale or security interest merely because it provides that the rental price is permitted or required to be adjusted under the agreement either upward or downward by reference to the amount realized upon sale or other disposition of the motor vehicle or trailer.

The objective of TRAC/state legislation is simply to ensure that TRAC leases are treated the same as all other leases for state law purposes and bankruptcy law purposes.

What the TRAC/state legislation says is that the mere presence of a TRAC clause in a vehicle lease will not destroy the "true lease" character of the TRAC lease. This clarifies the law and accords with tax law, accounting principles, and the trend in the court cases. See, e.g., 26 U.S.C. 7701(h) (federal tax law); Financial Accounting Standards Board Statement No.13 (accounting principles); Sharer v. Creative Leasing, 612 So.2d 1191 (Ala. 1993) (courts holds TRAC vehicle leases to be true leases, in lessor's

suit for deficiency judgment).¹

This TRAC legislation is designed to end wasteful litigation by recognizing the "true lease" status of TRAC vehicle leases. It is in the public interest to assure the parties to a TRAC lease that they can plan (and price) their TRAC leases knowing that the courts will recognize the "true lease" status of these widely-utilized lease transactions. Kansas' TRAC/state law makes irrelevant, not only the mere presence of a TRAC clause, but also the substantive impact of the TRAC clause. Equally irrelevant is whether the TRAC lessor retains the right to do as he pleases with the vehicle upon the expiration or termination of the TRAC vehicle lease. Rather, this TRAC/state law recognizes (like all the other TRAC/state laws in the United States) that a key feature supporting the true lease status of TRAC vehicle leases is that the TRAC lessor remains ultimately liable (contingent liability) for taxes and all the other attributes of ownership. Cf. Frank Lyon v. United States, 435 U.S. 561 (1978). When a TRAC lessor sells the vehicles at the end of the lease, for example, the lessor is subject to criminal and civil penalties (up to one year in prison and up to \$50,000 in fines) for any violation of federal odometer laws (see 15 U.S.C. 1981 et seq.). TRAC lessors would not retain this potential legal liability if a TRAC lease were simply a sale of the vehicles to the lessee. TRAC vehicle leases are true leases, as Kansas' TRAC/state law makes clear.

The impact of the proposed TRAC/state law is particularly important when the lessee is in bankruptcy. If a TRAC lease is viewed as a "true lease," then the Trustee in Bankruptcy must pay the lessor full rental payments for using the vehicles, and the lessor may recover the leased vehicles from the Trustee in Bankruptcy and re-lease them. On the other hand, if the TRAC lease is viewed as a disguised security interest, then the Trustee in Bankruptcy may keep the vehicles, and pay the lessor only an amount representing the depreciation on the leased vehicles (about 50% to 80% of full rentals). The difference to the lessor is significant.

To make sure that the impact of this legislation is felt immediately, we respectfully ask that Section 1(b) of House Bill 2687 be amended to read as follows:

¹ And see In re Otasco, Case No.90-C-300-E (N.D.Okl. 1991), overruling 111 Bk.Rptr. 976 (Bk.N.D.Okl. 1990) (TRAC leases held true leases in bankruptcy case); Basic Leasing v. Paccar, 1991 WL 117412 (D.N.J. 1991) (same); LMV Leasing, Inc. v. Conlin, 805 P.2d 189 (Utah App. 1991) (TRAC leases held true leases in lessor's suit for deficiency judgment); Addison v. Burnett, 41 Cal.App.4th 1288, 49 Cal.Rptr.2d 132 (6th Dist. 1996) (same); contrast In re Tillery, 571 F.2d 1361 (5th Cir. 1978) (TRAC leases held disguised security agreements, not true leases, in bankruptcy case).

(b) This section shall be part of and supplemental to the uniform commercial code. This act clarifies existing law and shall be given effect in all court cases brought on or after the effective date of the act. [New language in italics]

Once again, the objective of the bill is to end wasteful litigation by clearly recognizing the true lease status of TRAC vehicle leases.

Thirty-eight (38) other States and the District of Columbia have already enacted TRAC/state legislation. Major industrial States enacting TRAC legislation include (among others) California, Florida, Illinois, Maryland, Massachusetts, Michigan, Missouri, New Jersey, New York, North Carolina, Pennsylvania, Tennessee, Texas, Virginia, Wisconsin. The States that adopted TRAC/state legislation in 1996 are Connecticut, Delaware, Massachusetts and West Virginia. In 1997 Arkansas, Colorado and Maine enacted TRAC/state laws.

TRAC/state legislation in Kansas would clarify the law, make it uniform and predictable throughout the United States, lower transaction costs, and facilitate commerce in Kansas.

This legislation is supported in Kansas by NationsBank (with locations throughout the State of Kansas), Baystone Financial Group (Manhattan), First National Bank of Hutchinson (Hutchinson), and Transamerica Business (Overland Park) and two national trade associations representing vehicle and equipment leasing (the Equipment Leasing Association and the American Automotive Leasing Association). We know of no opposition.

We respectfully urge the Kansas Legislature to enact TRAC/state legislation in the public interest.